

Message Text

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46

ACTION ARA-10

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FM AMEMBASSY BRASILIA

TO SECSTATE WASHDC PRIORITY 4551

INFO AMCONSUL RIO DE JANEIRO

AMCONSUL SAO PAULO

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PASS TREASURY FOR BILL MCFADDEN (OASIA)

E.O.11652: N/A

TAGS: EFIN, BR

SUBJECT: BRAZILIAN CENTRAL BANK RAISES DISCOUNT RATE TO COUNTER
RISING INFLATION

1. SUMMARY: BRAZIL'S CENTRAL BANK RAISED THE
DISCOUNT RATE, EFFECTIVE MARCH 15, 1976, TO 22 PERCENT
FROM 18 PERCENT IN AN EFFORT TO HELP FIGHT INFLATION
WHOSE BEHAVIOR DURING THE LAST TWOMONTHS FAR SURPASSED
OFFICIAL EXPECTATIONS. THE FEBRUARY COST-OF-LIVING
INCREASE IN RIO DE JANEIRO, ONE OF THE MORE WIDELY-
OBSERVED INDICATORS OF INFLATION, JUMPED BY 5.2 PERCENT
--THE HIGHEST MONTHLY INCREASE FOR JAN/FEB TO 9.6 PERCENT.
THE GENERAL PRICE INDEX, A MORE ACCURATE DEFINITION OF
OVERALL INFLATION, WENT UP BY 4.2 PERCENT IN FEBRUARY,
THE HIGHEST SINCE MARCH 1974, WITH THE CUMULATIVE INCREASE
FOR THE FIRST TWO MONTHS REACHING 7.4 PERCENT. INFLATION

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HAS RETURNED TO THE FRONT PAGES, RECEIVING THE SAME

PROMINENT ATTENTION RECENTLY GIVEN TO THE BALANCE OF PAYMENTS. END SUMMARY.

2. THE CENTRAL BANK RAISED (EFFECTIVE MARCH 15, 1976) ITS BASIC RATE FOR COMMERCIAL BANKS' REDISCOUNTS TO 22 PERCENT FROM 18 PERCENT, A RATE WHICH HAD BEEN IN EFFECT SINCE JANUARY 1973. SINCE THE BASIC RATE IS APPLIED TO THE USE OF THE DISCOUNT WINDOW FOR AMOUNTS UP TO 5 PERCENT OF A COMMERCIAL BANKS' OUTSTANDING DEPOSITS ON THE PREVIOUS DECEMBER 31, RECOURSE BY THE COMMERCIAL BANKS TO THE DISCOUNT WINDOW IN EXCESS OF THIS 5 PERCENT LIMIT WILL RESULT IN THE APPLICATION OF A 28 PERCENT RATE AS AGAINST THE PREVIOUS 24 PERCENT. IN ADDITION, SHOULD A BANK UTILIZE THE DISCOUNT WINDOW FOR MORE THAN 20 DAYS WITHIN A 30-DAY PERIOD, (WHETHER OR NOT THE 20 DAYS ARE CONSECUTIVE), THE RATE WILL BE EVEN HIGHER. IT WILL BE 25 PERCENT, IF THE CREDITS UTILIZED ARE WITHIN THE 5 PERCENT LIMIT, AND 31 PERCENT, IF THEY EXCEED THE 5 PERCENT LIMIT: (THE OLD RATES WERE 20 PERCENT AND 26 PERCENT, RESPECTIVELY).

3. IN A PARALLEL MOVE, THE CENTRAL BANK FREED THE INTEREST RATES CHARGED ON LOANS MADE BY FINANCE COMPANIES AND INVESTMENT BANKS. THESE INSTITUTIONS WERE PREVIOUSLY FREE TO PAY GOING MARKET RATES TO ATTRACT FUNDS (MAINLY IN THE FORM OF BILLS OF EXCHANGE AND TIME DEPOSITS) BUT HAD TO OBSERVE INTEREST RATE CEILINGS ON THEIR LOANS WHICH WERE DETERMINED BY THE CENTRAL BANK.

4. WHAT SPURRED THE MONETARY AUTHORITIES INTO ACTION WAS THE BAD NEWS ON THE INFLATION FRONT. THE RIO DE JANEIRO COST-OF-LIVING INDEX, ONE OF THE MORE WIDELY OBSERVED INDICATORS OF INFLATION, WENT UP 5.2 PERCENT IN FEBRUARY, THE LARGEST MONTHLY INCREASE IN THE LAST SEVEN YEARS, BRING THE CUMULATIVE INCREASE FOR THE FIRST TWO MONTHS TO 9.6 PERCENT. THIS COMPARES WITH AN INCREASE OF 4.8 PERCENT DURING THE SAME PERIOD LAST YEAR AND 6.4 PERCENT IN JANUARY/FEBRUARY 1974. THE LIMITED OFFICIAL USE

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GENERAL PRICE INDEX (FOR PRODUCTS FOR DOMESTIC USE), A MORE ACCURATE DEFINITION OF OVERALL INFLATION, ROSE BY 4.2 PERCENT IN FEBRUARY, BRING THE JAN/FEB INCREASE TO 7.4 PERCENT. DURING THE COMPARABLE PERIOD LAST YEAR, THIS INDEX ROSE BY 4.6 PERCENT, AND IN 1974 (DURING THE SAME TIME) IT WENT UP BY 5.7 PERCENT.

5. COMMENT: THE AUTHORITIES WERE APPARENTLY SURPRISED

BY THE FEBRUARY INFLATION RESULTS. IN ANNOUNCING THE JANUARY FIGURE, FINANCE MINISTER SIMONSEN HAD PREDICTED THAT INFLATION WOULD TAPER OFF STARTING IN FEBRUARY. AS LATE AS JUST BEFORE THE FEBRUARY RIO DE JANEIRO COST-OF-LIVING INDEX WAS PUBLISHED BY THE GETULIO VARGAS FOUNDATION, SIMONSEN PUBLICLY STATED THAT THE FEBRUARY INCREASE WOULD BE AROUND 4.0 PERCENT (AS OPPOSED TO THE 5.2 PERCENT ACTUALLY REGISTERED). MONETARY OFFICIALS HAD OBVIOUSLY UNDERESTIMATED THE INFLATIONARY CONSEQUENCES OF THEIR EXPANSIONARY MONETARY POLICY OF THE LAST HALF OF 1975, WHEN THE MONEY SUPPLY JUMPED BY 33 PERCENT -- CAUSING THE YEAR-TO-YEAR INCREASE TO REACH 43 PERCENT AS AGAINST THE TARGET OF 30 PERCENT. WHILE THIS EASY MONETARY POLICY WAS DESIGNED TO STIMULATE ECONOMIC ACTIVITY, IT RAN COUNTER TO THE OBJECTIVE OF CONTAINING INFLATION WHILE REDUCING THE TRADE DEFICIT. BOTH THE FEBRUARY INFLATION RESULTS AND THE CONTINUED HIGH LEVEL OF IMPORTS (PRELIMINARY INDICATIONS ARE THAT IMPORTS IN FEBRUARY SHOWED LITTLE IMPROVEMENT FROM THE HIGH LEVEL OF JANUARY, SEE BRASILIA 2192), ARE A STRIKING REMINDER (IF ONE WERE NEEDED) THAT CONTAINING INFLATION AND REDUCING THE TRADE DEFICITS ARE NOT COMPATIBLE WITH AN EXPANSIONARY MONETARY POLICY DESIGNED TO STIMULATE ECONOMIC GROWTH.

6. THE AUTHORITIES SHOULD NOT HAVE BEEN CAUGHT COMPLETELY BY SURPRISE, IF THEY HAD READ CORRECTLY RECENT SHIFTS IN CONSUMER PREFERENCES. JUDGING BY TRENDS IN RETAIL SALES DURING THE LAST FEW MONTHS (THE THE SAO PAULO AREA RETAIL SALES WENT UP BY 55 PERCENT IN FEBRUARY AND 46 PERCENT IN JANUARY, OVER THE SAME MONTHS LAST YEAR) AND BY THE REPORTED INCREASE IN REQUESTS LIMITED OFFICIAL USE

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FOR REAL ESTATE RELATED LOANS, THE BRAZILIAN CONSUMER HAS INCREASED HIS PREFERENCE FOR REAL ASSETS WHILE DECREASING HIS DESIRE FOR MONETARY SAVINGS -- A CLEAR INDICATION THAT INFLATIONARY EXPECTATIONS HAVE TAKEN HOLD. THEREFORE, ONE OF THE MAIN OBJECTIVES OF THIS LATEST TIGHTENING OF MONETARY POLICY IS TO FUND THESE EXPECTATIONS, WHICH, AS EXPERIENCE INDICATES, ARE A MAJOR CAUSE OF INFLATION. ONE WAY TO BREAK THESE EXPECTATIONS IS FOR THE MONETARY AUTHORITIES TO REGAIN THEIR MONETARY POLICY CREDIBILITY, WHICH WAS DAMAGED BY THE BEHAVIOR OF THE MONEY SUPPLY LAST YEAR. THE INCREASE IN THE DISCOUNT RATE WILL HOPEFULLY GIVE CREDENCE TO FINANCE MINISTER SIMONSEN'S REPEATED PREDICTIONS THAT THE YEAR-TO-YEAR MONEY SUPPLY INCREASE IN 1976

WILL BE KEPT TO 25 PERCENT. THE FACT THAT THE
AUTHORITIES ARE SERIOUS ABOUT MEETING THIS TARGET EVEN
IF IT MEANS SLOWER ECONOMIC ACTIVITY WAS DEMONSTRATED
BY HAVING PERMITTED FINANCE COMPANIES AND INVESTMENT
BANKS TO CHARGE MARKET RATES ON THEIR LOANS, A MOVE
WHICH WILL SURELY INCREASE THE COST OF
CONSUMER CREDIT THUS DEPRESSING TOTAL DEMAND.
CRIMMINS

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